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Economic Conditions
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General Business Conditions

THE reports of business during May have been of the same general character as in April. The industries have well-filled order books to work on, and production in most lines is holding at peak levels, past the time when a seasonal tapering off is usually expected. In factory operations percentage gains over last year compare favorably with previous months, the indexes of production averaging 18 to 20 per cent higher, and June is certain to be another good month. Employment and payrolls are at the peak of the recovery.

The continued large increase in farm income, 24 per cent in April as compared with a year ago, is another item on the optimists' side. The crop start is fairly favorable, and in the Northwest is inspiring hopes of better business conditions than in any recent year. The railroads are doing well, with car loadings running about 15 per cent over a year ago, and earnings and purchases up by a greater margin.

On the other hand, the slackening of new business in the industries, which appeared in April, has carried over into May also. In consumers' goods lines particularly orders have run well below shipments for the second successive month. Disappointment with retail sales is expressed in some areas. New York City department store sales, in dollars, were up 5.7 per cent in the first half of May, which after allowance for higher prices leaves the quantity of goods sold no greater than last year. Reports from the South and West, and from the mail order houses, are better. Judged by the increase in the purchasing power of farmers and industrial workers, retail prospects appear very satisfactory, and in part the sluggishness is probably due to a late Spring.

Commodity and security markets have continued easy during a good part of the month. Any showing of weakness in the markets is an influence for conservatism in buying or planning, on the theory, rightly or wrongly, that it foretells either a slackening in business or a decline in profits. It makes the pessimists feel that their views are confirmed, and the optimists wonder whether they are overlooking anything unfavorable.

Moreover, market reactions breed conjecture and rumor. They cause business men to put more stress upon the uncertainties which are always present, and arouse fears which in fact may have little basis. The persistence of reports of an impending cut in the price of gold is a case in point. These reports continue to circulate both in this country and abroad, although the Administration has stated frequently and plainly that no change is intended, and it has always been the opinion of students of the question that the rumors were entitled to little credence.

Boom and Reaction

There is no reason to find any mystery in the reaction in the markets and the slackening of new buying. Business tends normally to swing forward and backward, and each swing is a reaction from the conditions preceding. In the last quarter of 1936 and the first quarter of 1937 there was a very rapid rise, both in prices and business activity, all over the world. Business men were buying ahead, speculators were helping the movement along, and the inducement to cover forward requirements was great enough for a time to outweigh all other considerations. The result was a temporary congestion, most acute in the markets where speculators were most active.

During the past two months this congestion has been relieved in two ways, by the increase in production, and by speculators turning sellers. The reaction in the markets was inevitable and wholesome. It has been most pronounced in London, and in the commodities entering international trade, which were centers of speculation. The drop in our staple commodity prices was part of the world decline, and our security markets were affected also, both because the abnormally large foreign investments in American securities made them sensitive to disturbance abroad, and because rising industrial costs, labor difficulties, ques-

tions as to Government policy, and other conditions were creating uncertainty here.

With the speculative advances corrected, the outlook for the Autumn is improved. It is fair to say that commodity prices in the main are neither too high nor too low; they give reasonable returns to producers, and do not over-burden consumers. A good working balance in prices promotes trade. Conversely, continuation of the rapid advances, and over-extension of the boom psychology, would have menaced Fall business.

The forward buying which put up the markets during the first quarter left the industries with heavy backlogs of unfilled orders, against which they are now working. The slackening in new business is explained by these backlogs, for when the industries are sold far ahead buyers obviously are well covered. Of course no one can yet foretell what the situation will be when manufacturers begin to need more business. If buyers have not over-estimated their requirements they will be back in the markets in good time. However, a rapid and prolonged forward movement in trade and prices is admittedly more likely to induce over-buying and accumulation of inventories than the contrary, and this is the uncertain factor.

The Situation in Textiles

In the consumer goods industries business has been on the rise since the Spring of 1936 (to go no farther back), and since last Fall has been plainly in the "boom" area, substantially above the 1929 peak. Hence it is among these industries that over-production and recession are most likely to occur. Invariably they move up and down more rapidly than the heavy industries, where the swings are longer, and according to common experience they would be expected to react after a year of record-breaking output.

There are signs that cotton mill activity is passing its peak, the most important instance of curtailment being that of the Berkshire Fine Spinning Associates in the Fall River district. As a whole the print cloth and sheeting mills still have orders to carry them along for a good many weeks, but they have not been selling their production for about 2½ months, and some mills may run out of orders before the next seasonal buying comes along. Cotton consumption during the current crop year, ending August 1st, will apparently be 11 per cent larger than the previous record year, and few manufacturers expect to see this rate maintained through another season.

Woolen mills are active on unfilled orders, but new business is quiet; and a moderate easing in raw wool prices despite a strong statistical position indicates a less insistent demand.

Figures compiled by the Federal Reserve Banks supply indications that department store inventories of textile products and other general merchandise have been rising faster than sales since the first of the year, as would be expected following the forward buying. This is a trend which in time leads to reduced production. However, inventories are not disturbingly large, according to past relationships to sales.

The Capital Goods Industries

In the capital goods industries production with few exceptions is still below 1929 levels, and below capacity. The shortages of capital goods created by the depression have not been made up, and the demands that are coming along with rising prosperity are making these shortages critical. The production of housing, of heavy electrical and railway equipment, and machinery, has increased greatly in the past two years, and these industries are strongly on the upgrade, but no informed person claims that the needs are satisfied, or that the market for these goods is being over-supplied.

During the past two months demand for capital goods has been sustained better than demand for goods of every-day consumption. Machine tool orders in April were highest ever recorded in the industry; the index climbed to 282.5 (1926 = 100), compared with 125.7 in April last year, and 186.3, the peak in 1929. More railway freight cars were on order on May 1 than on any corresponding date since 1926. There is no lack of announcements of programs for corporate expenditure. Steel, automobile and tire companies are all spending to modernize, decentralize and increase plant facilities; the Phelps Dodge Corporation is embarking on a five-year program of ore development and additions to equipment; and among others raising money for expansion and working capital are du Pont, Allis-Chalmers, and Socony-Vacuum.

No severe recession in industrial production is likely as long as business men are investing capital and spending on plant and equipment. The consumer goods and capital goods groups of industries are of about equal importance in the aggregate business of the country, but the greatest fluctuations are in the latter, and the variations in business volume are influenced more by variations in business spending than by changes in consumer purchasing power traceable to other causes. It is therefore possible to have a decline in textiles, and in goods of like character, without more than a minor recession in total industrial activity, provided business spending continues. Fluctuations of this kind in consumers' goods are normal and familiar.

Automobiles, Steel and Building

Reports from the automobile industry are uniformly excellent. May production is estimated at 548,000 cars and trucks, compared

with 480,518 last year. Available sales figures for the early part of the month show increases of 20 per cent and upward over last year. The companies whose production was interrupted by strikes are behind in deliveries; their dealers are short of stocks and would be selling more cars if they had them. The covering of this short position will maintain peak production for some time. Morever, the new models will be introduced earlier next Fall than was the case last year, and the changeover period therefore will be short, a factor of importance to the steel industry and others supplying the automobile manufacturers.

Steel mill operations continue above 90 per cent of capacity, except as strikes have interfered. Producers have good backlogs of orders, and according to the Iron Age new business for most companies has been running about 75 per cent of shipments, a good showing after the heavy buying earlier. The delivery situation is easier than it was a few weeks ago, but the industry does not expect to curtail operations appreciably, of its own volition, at least until the railway orders now on the books are filled and seasonal slackening in other industries reduces the amount of steel they are taking. Of course the strike against Republic, Youngstown, and other companies makes any prophecies as to production hazardous.

Building contracts awarded in April increased more than seasonally over March, but declined again in the first half of May, when they were only 1 per cent over the corresponding 1936 figure. Contrasted with the hopes of a substantial gain in building this year, the figures are disappointing, and they seem to be proof that the rise in materials and labor costs this Spring has upset plans for new construction in some quarters. The encouraging aspect is that the decline is in public works; privately-owned building has expanded enough to make up for that loss, and in April represented three-fourths of the total.

The Capital Markets

The state of the capital markets is an important factor in the rate of business spending, especially when the penalty placed upon expenditures out of earnings by the undistributed profits tax is considered; for corporations of any size usually must raise their new capital through stock issues, or borrow by selling bonds. The decline in the bond market in the early part of the year has slowed down the issue of new securities, and this is cited as an unfavorable factor in the outlook for the capital goods industries. Nevertheless, the total new money raised by domestic corporations during the first four months of the year was 60 per cent larger than in the same period last year. It seems overly pessimistic, in view of good business earnings and the general ease of money, to assume that the flow of capital into investment through the public markets will be restrained for very long. The interest return offered on new issues had declined at the beginning of the year to rates which were unattractive to lenders, which may be the best explanation of the break. Once the uncertainties wear off and borrowers and lenders find the rate upon which they can meet, it may be that more new money will be available than before, and capital flotations more active.

The rise in labor costs, due to higher wages, shorter hours, and working restrictions, tends to stimulate capital expenditure for a time at least. Only by improving productive methods can prices be kept down, and low-cost production requires investment in modern plant and machinery. One of the stated purposes of the General Motors Corporation's $40,000,000 program is to increase capacity so as to reduce the need for overtime work, with its added costs.

Money and Banking

On May 1 the latest increase in reserve requirements of all member banks went into effect, in accordance with the program announced by the Board of Governors of the Federal Reserve System on January 30, last. This increase was the third of a series inaugurated in August, 1936, for the purpose of eliminating a portion of the huge quantity of excess reserves built up largely as a result of gold imports since devaluation of the dollar, and whose existence was regarded as providing a basis of possible injurious inflation. The following table shows, by classes of banks and deposits, the reserve requirements in effect prior to August 15, last, together with dates and amounts of subsequent changes:

Reserve Requirements of Member Banks

	Demand Deposits			Time Deposits
	Central Reserve City Banks	Reserve City Banks	Country Banks	Total
Prior to Aug. 15, '36	13%	10%	7%	8
Aug. 15, '36 to Feb. 28, '37	19½	15	10½	4½
Mar. 1, '37 to Apr. 30, '37	22¾	17½	12¼	5¼
May 1, '37 and after	26	20	14	6

Reduction of Excess Reserves

With the advance in reserve requirements on May 1, excess reserves declined by $750,000,000 to $890,000,000, the lowest since February, 1934, though larger than at any time prior to 1934. In making comparisons allowance should be made, of course, for the diminished expansive power of reserves under the higher ratios of reserves to deposits now required.

In the following table we give data showing the successive steps by which excess reserves have been reduced from the peak, which for all member banks was reached in Decem-

ber, 1935. Figures include actual and percentage excess reserves, together with distribution, on December 11, 1935, on first reporting dates following changes in reserve requirements, and on the latest available reporting date this year.

Excess Reserves of Member Banks—Actual and Percentage Excess

(Figures for Actual Excess Reserves in Millions of Dollars)

	Actual Excess Reserves				Percentage Excess			
	N.Y.C.	Chi.	Other	Total	N.Y.C.	Chi.	Other	Total
Dec. 11, 1935	$1,467	$387	$1,450	$3,304*	128	152	108	121
Aug. 19, 1936	502	175	1,136	1,813	28	42	51	41
Mar. 3, 1937	348	43	919	1,310	16	9	34	24
May 5, 1937	105	56	729	890	5	10	23	15
May 26, 1937	227	49	664	940	10	9	21	16

*Peak for all member banks.

It will be seen that for all member banks the *actual* excess of reserves held over and above legal requirements dropped between December 11, 1935, and May 26, 1937, from $3,304,000,000 to $940,000,000, while the *percentage* of such excess fell from 121 to 16. In the case of New York City banks alone the decline in actual excess reserves during the same period was from $1,467,000,000 to $227,000,000, and in the percentage of excess from 128 to 10.

In other words, the decline in excess reserves has been heavier relatively for New York City banks than for the banking system as a whole. Whereas in 1935 the percentage of excess reserves held in New York City was greater than that held by all member banks, the reverse is now true, as the table shows.

Recent Changes in Bank Credit

Changes in member bank credit during May included a continued growth of commercial loans, though at a slower rate than in previous months. Thus, "other" loans, as classified in the bank statements prior to May 19 (and considered roughly indicative of commercial borrowing) increased $31,000,000 between April 14 and May 12, followed by an increase of $6,000,000 in "commercial, industrial and agricultural loans," as shown by the new form of statement published in the week of the 19th. Taken together, the figures fall considerably short of the $350,000,000 rise in "other" loans (old form) that took place in the two and a half months preceding, but are interesting, none the less, as showing a prolongation of borrowing past the usual seasonal peak. Moreover, figures available at this writing for New York City for the week of the 26th were up over those of the 19th.

Bank liquidation of Government securities continued during the past month, though with considerably less urgency than before, as evidenced by a decline of only $23,000,000 in reporting member bank portfolios during the two weeks ended May 19. The decline, however, sufficed to bring the totals down to a new low level for the year, off approximately a billion dollars since the first of January.

The bank selling of securities to non-banking purchasers has tended to cancel deposits, but owing largely to expansion of commercial loans, gold imports, and expenditure of Government deposits, the total of demand deposits adjusted (demand deposits other than those due to banks and to the Government) has shown no net change since the first of the year. Since these deposits constitute the checking accounts of individuals and corporations, their failure to decline is a factor that should not be overlooked in considering the decline in total deposits over the period. Inter-bank deposits are down heavily since last December, due chiefly to recall of over $600,000,000 of out-of-town funds from New York, evidently in connection with interior adjustments to higher reserve requirements.

Money Rates and Bond Market

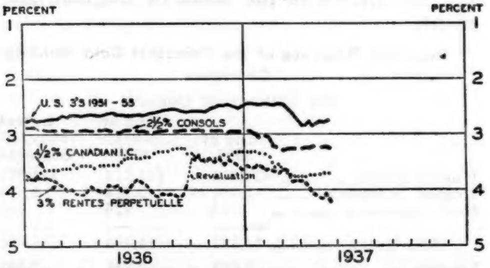
The money market has shown signs of slight relaxation, and certain highly sensitive open market rates have slipped back a trifle from the highest levels of the season. The average discount rate for 273-day Treasury bills, after making a peak at 0.738 per cent on May 5, eased to 0.617 per cent by the 26th, while bankers' acceptance rates were reduced $\frac{1}{16}$ to $\frac{1}{8}$ of 1 per cent, bringing the 90-day maturity to $\frac{9}{16}$ per cent bid, $\frac{1}{2}$ per cent asked. Otherwise, open market short-term rates remained unchanged. Despite the slight easing indicated, prevalent opinion is that there will be little change in money rates before Fall, when the trend will be conditioned by the extent of the Fall upturn in business.

The bond market over the past month has given a good account of itself, all things considered. Investors have continued in a decidedly cautious mood, following the severe shake-down of two months back, and trading much of the time has been the dullest in many months. Prices, however, of Government and other high grade bonds have been steady for the most part, above the lows, with moderate upward tendencies in some groups. Towards the close of the month the Supreme Court decision upholding the constitutionality of the Social Security Act, including the payroll taxes and the pension fund (which is expected to absorb large quantities of Government issues), exerted a favorable influence upon the market.

On balance, developments of the month affecting gilt-edge issues have been more constructive than otherwise, including, in addition to removal of doubts with respect to the social security legislation, the easier tone of the short-term money market, the lessened urgency of bank liquidation, and the recession of commodity prices, with consequent abatement of

the fear of inflation. The latter development, it may be added, acquires further significance in that it tends to give the Reserve Banks a freer hand in the pursuance of their cheap money program. Among other evidences of improvement in the bond situation should be mentioned the fact that the Federal Reserve Banks did not feel called upon to add to their holdings of Government securities during May, following net purchases of $96,000,000 during the previous month.

In line with the greater stability shown by high grade bonds in this market within recent weeks has been the action of government bonds in the London and other foreign markets. The accompanying diagram presents a comparison of the trends of representative long-term bonds of the governments of the United States, Great Britain, Canada and France. It will be seen that since the first of the year movements in the markets of the first three countries have been a good deal similar, except that the decline in British and Canadian Government bonds preceded the weakening of the Government bond market in this country.



Yields on Representative Long-Term Government Bonds of the United States, Great Britain, Canada and France.

Reference has been made above to the importance attached by the bond market to the outcome of the Social Security cases before the Supreme Court. Reason for this, of course, lies primarily in the increasing investment requirements of the accumulating old-age pension and unemployment insurance funds. On the basis of the latest Presidential estimates forecasting a budget deficit for the coming fiscal year at $418,000,000, exclusive of sinking fund, the estimated absorption during the year of Government securities by the old-age benefit fund, unemployment trust fund and other trust funds, and allowing for continued sale of "baby bonds," will amount to approximately $1,400,000,000, which would mean that $1,000,000,000 of securities would have to be taken out of the open market.

Should the Federal net deficit of $418,000,000 be eliminated altogether, and a "layman's balance" be achieved (that is, exclusive of sinking fund), the indicated amount of securities required from the open market during the fiscal year 1938 would be nearer to $1,400,000,000.

These estimates of borrowing requirements, however, take no account of the borrowing that may be necessary to finance additional gold purchases by the Treasury to be put into its "inactive gold fund," the amount of which is indeterminable, but which at the rate gold has been coming since the first of the year would amount to more than 1¾ billion dollars for the present calendar year. Moreover, the estimates are predicated upon the budget figures, as revised, being realized, and any increase in the actual deficit would change the estimates accordingly.

The volume of new financing continued on a generally restricted scale during May, as dealers have been disposed to await more settled conditions before attempting new business. Several important offerings, however, were brought forward, including $45,000,000 Southern Bell Telephone 25-year 3¼s at 96½, and $25,000,000 Federal Home Loan Bank 1-year 1½ per cent debentures at 100, the latter issue representing the first public financing of the Federal Home Loan Bank System. Both issues met an excellent reception. At the present time more than $150,000,000 of new financing is in registry with the Securities and Exchange Commission awaiting a favorable market.

The Gold Movement

Gold continued to come to this country throughout the month of May, but in somewhat smaller quantities than in April, when the aggregate was $215,000,000. Nevertheless, even during May the gold imports exceeded $135,000,000, to which amount must be added about $26,000,000 released from earmark during the month. Our total net imports of gold this year approach $750,000,000 and have gone into the Treasury's sterilized gold fund.

A large portion of the gold now received in this country, as well as in Great Britain and the Netherlands, has come from private holdings in monetary centers of Western Europe. The reappearance of this gold has been responsible for a rapid increase of gold reserves in those three countries, which have risen at a rate well over $200,000,000 per month since the beginning of the year. The monthly output of new gold (outside of the Soviet Union) has averaged lately about 2,380,000 fine ounces or $83,000,000, part of which goes to satisfy the gold requirements of the arts and industries.

Dehoarding of gold in Southeastern Asia, which has been going on since 1931, has also contributed to the supplies. The shipments have dwindled in the last half-year to about $8,000,000 per month, and improvement in economic conditions there is putting an end to distress sales. The Bank for International Settlements reports that the disappearance of gold coins from circulation in Java and the

sudden rise of silver absorption in British India in 1936 point to a renewed interest in precious metals in the Far East.

Dehoarding in Western Europe

Apparently we are in the midst of a second major movement of gold out of the private holdings of monetary centers of Western Europe. The first dehoarding movement set in soon after the stabilization of the dollar in 1934, when Americans sold gold acquired in London, mostly in 1933, for repatriation of the proceeds to the United States. This dehoarding movement continued into 1935, when it was counter-balanced by the revival in hoarding in the former gold bloc countries. A study by the Bank for International Settlements put the amount of "disappeared" gold from September, 1931, to the end of 1935 at about $2,000,000,000 (new valuation), including gold held by various stabilization funds.

The hoarding continued to the end of September, 1936. In France alone, as the Bank for International Settlements estimates in its latest annual report, about 5,400,000,000 francs ($360,000,000) was held outside of the Bank of France at the time of revaluation.

With the devaluation of gold currencies, and establishment of the tripartite currency agreement, hoarding of gold again diminished, and partly because of legislation and partly because of the changed attitude of hoarders of gold, the "disappeared" gold began to be tendered once more to various central banks or in London. The report of the Bank for International Settlements continues:

> It will be recalled that a new monetary law (in France) made surrender of gold obligatory, with certain exceptions, for all persons and corporate bodies domiciled in France. From the beginning of October 1936 up to March 1937 private gold sales to the stabilization fund and declarations by traders and industrialists are valued at nearly 40 per cent of the estimated gold held privately in France.
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> During the last period of 1936 an amount of 150 million gold Swiss francs ($50,000,000) was obtained from hoards within Switzerland and an amount equivalent to about 100 million gold Swiss francs within the Netherlands ($33,000,000). Less precise information is available for other countries; it is known, however, that dehoarding of gold occurred in the London market on a fairly extensive scale during the last quarter of 1936 . . . It seems safe to assume that during 1936 in all an amount of at least 1,000 million gold Swiss francs (330,000,000 dollars) was obtained in Europe from hoards previously accumulated.

At the present time gold is reappearing from the private holdings in Western Europe at the rate of roughly $100,000,000 a month. Because of the absence of data on gold stocks held in various stabilization funds, it is naturally impossible to ascertain how far dehoarding progressed and how much more gold is still available from these sources. The movement of course is temporary, and the hidden supplies of gold must eventually run dry. For the present, however, central banks are faced not only with the absorption of larger supplies of newly-mined gold, hitherto usually reduced by hoarding, but with the absorption of privately held gold as well.

The shipment of Russian gold to London has been another development which has augmented the current supplies of gold. Despite the rapidly expanding output, very little gold was shipped out of the Soviet Union, after the repayment of trade credits in 1934, until this year. Hence, the effect of the larger output of Soviet gold was not felt on the outside. Out of the announced shipment of $190,000,000 of gold only $120,000,000 has thus far been received in London, mostly during April.

Absorption of Gold Supplies by Great Britain and Continental Countries

The burden of the absorption of larger supplies of gold continues to be borne principally by the United States, Great Britain and the Netherlands, with this country far in the lead. In five months, central banks of these three countries added almost $1,100,000,000 of gold to their stocks. Another $110,000,000 must be added to this latter figure for gold retained in Great Britain since the beginning of the year, but not shown in the Bank of England statement.

Reported Reserves of the Principal Gold Holding Countries

(In Millions of Dollars)

	End of 1936	End of March 1937	Latest May, 1937 Statement
United States	$11,258	$11,574	$11,977
United Kingdom	2,584	2,584	2,654
Netherlands	490	626	769
Sub-Total	14,332	14,784	15,400
France	2,995	2,846	2,845
Switzerland	655	657	634
Belgium	632	619	607
Sub-Total	4,282	4,122	4,086

In Great Britain the net imports of gold during the last two months were comparatively small. Since the beginning of the year, however, the country retained about $175,000,000, including the $110,000,000 above mentioned, and about $65,000,000 taken over by the Bank of England after May 5, presumably via the exchange equalization fund. This addition brought the Bank's gold reserve to a new high of $2,654,000,000 (£322,000,000 at the old price). A new high record was also established for currency circulation in May, reflecting greater business needs during the coronation festivities and Whitsun holidays.

In less than five months the gold reserves of the Bank of Netherlands increased almost $280,000,000, an important amount of gold considering the size of the country. In the first few months after the devaluation of the guilder the imports of gold represented largely the repatriation of Dutch capital. Subsequently, however, international capital began to seek both refuge and investment in the Nether-

lands, not only because of her sound fiscal position and a rapid revival of business, but also because of the opportunities in the Dutch Colonial Empire. The East Indian Archipelago has particularly benefitted by the revival of activity and the rise of price of raw materials.

The Dutch stabilization fund several times has replenished its guilder balances by sales of gold to the Bank of Netherlands. It has also attempted to stave off the inflow by raising the dollar-guilder rate, thereby lowering the gold price in guilders, but with no great effect on the gold inflow. At the present time the gold holdings are practically twice as large as they were early in October, 1936, and if revalued would provide gold cover of about 170 per cent for the Dutch circulation. The guilder is now being quoted at 54.99 cents against the low of 54.40 established early last February.

In Switzerland, the bulk of the Swiss capital repatriation occurred within one month after the devaluation. Quotations of shares and bonds on the Swiss stock exchanges rose very rapidly during the period of influx and, as the Bank for International Settlements points out in the last report, "there was very little inducement for foreign capital to invest in Swiss securities and, in fact, few such investments were made. By the end of the year the return flow of Swiss funds was coming to a standstill and at the beginning of 1937 there were even some signs of renewed export of Swiss capital for the purchase of securities in the United States and elsewhere." As may be seen from the preceding table, there was actually a small decline in the gold holdings of the Swiss National Bank in the past two months.

Contrasting with the experience of most countries following devaluation, the return of capital to France has been disappointing thus far. This is due to the continued political and economic uncertainties in the French situation. During the first month after revaluation the gold reserves of the Bank of France rose by about $317,000,000, but apparently the return flow was reversed in November and following months. By the third week in January the gold holdings of the Bank were back at the level on which they stood on October 2, one week after revaluation, and have remained practically stationary since then.

Capital Inflow to Argentina

A review of capital and gold movements would not be complete without reference to the flow of international capital to Argentina, not only because this reflects the steady improvement of the country's financial position, but also because it points toward another possible source of demand for gold. The inflow has taken the form of an accumulation of gold and foreign balances abroad in Argentina's favor. The Government has acquired these foreign assets with the proceeds of sales of treasury bills, thereby sterilizing them in a manner similar to that used by the United States Treasury in handling incoming gold. A recent 200,000,000 peso ($61,500,000) loan, oversubscribed within three days, reimbursed the Government for its outlays.

The inflow of capital and the exceptionally large export surplus accumulated during the first four months of this year (estimated at about 640,000,000 pesos) have enabled the Government to convert a large part of the external debt into internal debt, thus diminishing possible problems of foreign exchange transfer in the future. The repatriation and the conversion of the dollar debt, service on which represented the most burdensome single item in the Argentine balance of international payments, has already resulted in substantial savings. As President A. P. Justo pointed out in an address inaugurating the Argentine Congress, the service on external debt on May 1 required only about $28,000,000, against $35,000,000 last October. The total external debt in May, 1937, was about $352,000,000 against $450,000,000 in October, 1936. The servicing of the external debt has been made easier also by the gradual appreciation of the peso.

Cotton, Cotton Goods and World Trade

We gave last month an account of the lasting effects of the Great War upon the cotton goods industry of the world, and of the voluntary agreement recently announced between the cotton goods organizations of Japan and the Cotton Textile Institute of this country, limiting cotton goods shipments from Japan to the United States. Much space has been given in histories to the "Industrial Revolution" which began with the invention of the steam engine about 150 years ago, but only recently has this "revolution" reached the dense populations of Asia, which have used hand-labor only.

The first power-driven cotton mill in Japan was equipped in 1862, with 5,000 spindles, imported from England and operated by water-power, which is abundant in Japan, and is one reason for its low-cost of cotton goods. The industry developed but slowly, for Japan had no modern industries then, or capital for their development. By 1885 Japan had acquired approximately 300,000 spindles.

The war with Russia (1904-05) gave Japan a serious set-back, financially and industrially, making capital hard to obtain and being followed by "hard times". Nevertheless, by 1910 Japan had 2,000,000 spindles, and in 1914, when the World War broke out, it had 2,500,000. This equipment had been acquired abroad, and paid for with patient Japanese toil and thrift, by means of Japanese exports, chiefly raw silk produced on the little "farms," and largely by women and children, in addition to the family

food. Then came the World War and Japan's opportunity. The War's interference with British exports of cotton goods, together with the great rise of prices in Europe and America, opened world markets, and especially the markets of Asia, to Japanese goods, and the profits created capital rapidly. By 1920 Japan had 3,800,000 spindles and in 1922, 4,500,000.

At this time Great Britain had approximately 60,000,000 spindles and the United States 37,000,000, or together 97,000,000, which was 60 per cent of all the cotton spindles in the world. If the countries of western and central Europe be added, the entire group held 84 per cent of all the spindles of the world, while all Asia held but 8 per cent.

In 1923 came the earthquake and fire, which destroyed Japan's capital and chief seaport, and seemingly wrecked the nation financially, but the Japanese people drew their belts tighter, and industrial development went on. At the end of 1936 the Japan Cotton Spinner's Association reported 11,850,000 spindles under its control, and these spindles, up-to-date and efficiently handled, (together with double labor shifts) used more cotton in 1936 than all the spindles of Great Britain or of any other country, excepting the United States. In 1936 one-half of the world's production of cotton was consumed by countries "new" in cotton goods. Moreover, practically none of the cotton goods production of the United States could be exported, on account of high costs, and in December, 1936, the United States industry sent a delegation to Japan to urge the Japanese industry to desist from any further increase of exports to this country because they were making serious trouble. Furthermore, every country producing cotton goods, including the other countries of Asia, was adopting defensive measures against the "flood" of Japanese goods. If this is not an "industrial revolution," what should it be called?

Limits of the Revolution

However, the "revolution" is mainly confined to the "low-wage" countries which are just beginning to apply machinery to industry. The United States and countries of western Europe are chiefly affected as they have built up industries for supplying the hand-labor peoples with goods which the latter are now proceeding to make for themselves. Hence Great Britain is the chief sufferer, while the United States has suffered but slightly. However, there is a tendency to exaggerate the disturbance, even in Britain, for all industries are continually changing among progressive peoples, and the latter are learning to adapt themselves to changes which prove beneficial instead of harmful. Thus although England has lost business and employment in some branches of the textile industry, she has been gaining in the fine goods, and in new industries, as rayon, celanese, silk goods, automobiles, radios and many new products. On the whole, notwithstanding some declining industries, there is more employment in England today than in the pre-war years, when the cotton goods industry was at its peak.

At first thought, the rapid development of the cotton goods industry in Japan and other low-wage countries tends to suggest that as the use of machinery spreads throughout these countries, the world will be swamped with overproduction, and no one's job will be safe. However, similar changes have aroused passing alarm before. On second thought, it should be clear that neither the Japanese, Chinese, nor all the low-wage peoples together, can do all the work of the world, even with machinery; because first of all, they want the machinery to work for themselves, just as it works for us. The reason Japan wants to sell cotton goods to us is that she must somehow pay us for the raw cotton, the iron and steel, automobiles and other goods, which she cannot produce for herself and is eager to buy of us. Her wants keep pace with her ability to pay, *and a little more,* as the trade record shows. She has bought more from the United States over the last five years, than we have bought from her, and it troubles her, because she wants to buy more, and lacks the income to do so.

The Gentlemen's Agreement

The "gentlemen's agreement" between the cotton goods interests of the two countries is a signal achievement, because it affords time for conference and cooperative action upon a new situation which was threatening injury to both parties. However, the situation was not as bad as it looked. Total cotton goods produced in the United States in 1936 was equivalent to about 8,700,000,000 square yards, and that of Japan about one-half as much. The rapid increase of our imports from Japan startled the American producers, by reason of the prices quoted, rather than the volume of goods actually moving. It was suggested that, as a matter of mutual concern, the Japanese should restrict such imports to 100,000,000 square yards per year, which would be but slightly more than one per cent of our domestic production. This was acceded to, and the situation is thus protected for at least two years.

It is true that a comparatively small volume of any product, offered at abnormal prices, may seriously unsettle a market, and the cotton goods industry had been operating at practically no profit for a number of years. Hence the action was prudent and proper. But how many goods could the Japanese industry possibly send to this country? It certainly could not send more than it could make, and the Japanese industry has been running double shifts regularly, and something more. Japan might, in time, increase plant capacity, but

how long would it take, with the low incomes of her people, to accumulate the capital necessary to supplant the United States in the cotton goods business?

Furthermore, this leaves out the most important consideration of all, which is that the primary job of the Japanese industry is to make cotton goods for the Japanese people. As we have seen, one of Japan's principal reasons for export business is that she must buy raw cotton to supply this domestic need; and here we meet on common ground, for cotton is our principal commodity in foreign trade. There is no such thing as a one-sided *trade.* Do we care for the Japanese market for our cotton, and if so, how can a mutually advantageous "trade" be arranged? This is a subject for friendly conference.

The Japanese Cotton Industry

In considering the rise of Japan and other low-wage countries in international trade, it is important to understand their home conditions. Mention has been made that the early development in cotton goods has been in the production of yarn for hand-weaving. This is because the power-spinning machines save more labor than do the power-looms, and the latter require a larger investment. The time may come when Japan will do more weaving by machine power, but this will be when capital is cheaper and wages are higher. At present Japan seems to have beaten us at the problem of supplying factory employment to low-paid farm workers.

Japan has two associations of cotton-goods manufacturers, viz: "The Japan Cotton Spinners' Association," composed of approximately 60 important corporations, and "The Nippon Union of Cotton Textile Manufacturers Association," composed of middle-sized and small loom operators, controlling, in the aggregate, 5,590 weaving establishments, belonging to 67 textile unions, all engaged in making cotton cloth, and scattered widely over Japan. These units range in size from the largest one, having 600 power-looms and 300 workers, down to those having but one, or a few, hand-looms with family workers, or employes, and usually not more than ten looms. These factories buy yarn from the large spinning companies and produce the greater part of the cotton cloth made in Japan.

The primary function of the big spinning corporations is to supply yarn to these weavers. The latter sell to the "Japan Cotton Merchants Union" or the "Cotton Yarn and Cloth Exporters Union," which are the principal channels through which cotton cloth is distributed. The corporations doing both spinning and weaving sell their surplus abroad, but it would make trouble in Japan if they restricted sales to the thousands of small weavers in order to increase their sales for export. The weavers have the first claim on the yarn production, and all parties work together harmoniously.

Agriculture and Industry in Japan

Japan has a population of 70,000,000 and is growing at the rate of a million a year. In relation to its arable land, the density of the population is twice that of Belgium and four times that of Great Britain.

The population is classed as mainly "agricultural," there being about 5,600,000 "farms" which is less than 1,000,000 below the number reported for the United States by the census of 1930; but nearly 2,000,000 of the Japanese farms are of less than one-fourth acre, and another 2,000,000 have plots ranging up to 2½ acres. It is practically "spade farming".

The raw silk industry was developed under similar conditions, and for years supplied the chief product for foreign trade, but the new rayon industry (artificial silk) has been as great a menace to the silk farmers as the new cotton goods industry of Japan is to the cotton goods producers of the world. In 1929 United States imports of raw silk from Japan were valued at $356,000,000, and in 1934 had fallen to $70,000,000. Japan has struggled to make this up by other exports, among them cotton goods. Thus the need for factory employment for the people has been intensified.

Another cause of increasing Japanese exports has been the low exchange rate of the yen to the dollar. It has been charged that this is a deliberate device, but a country's exchange rate declines when the balance of trade turns against it, and must go down until a balance is found. Her declining silk exports afford as valid an explanation of Japan's exchange rate as the fall of coffee does for the low Brazil rate. It is true that the lower exchange rate has aided Japanese exports, but the low rate has resulted from a lack of exports, and the Japanese are trying their best to increase them. It is also true that the main factor in the growth of textile exports has been low wages, but back of these is the desperate need of the farm population to have more income.

Most of the mill-workers are daughters of farm families, between the school age and marriage. Japanese married women seldom work outside their homes. The home earnings of these daughters above living costs are scarcely enough to count, and they are eager for mill wages and the mill life. It has been described as "peonage" or "slavery," but what might be said of life on these little "farms" with silk at recent prices? It is true that the girls live on the mill premises and are not allowed to be abroad at night; but they are far from their homes, and they, their parents and public opinion, approve of these arrangements. One of the best results of the recent American textile mission to Japan has been the clearing-

up of misinformation on this subject. Dr. C. T. Murchison, President of the Cotton Textile Institute of this country, and Chairman of the American delegation, in an address describing the mission to the Textile Square Club, N. Y., on the delegation's return, referred to the Japanese mill employes as follows, in part:

Approximately 80 per cent of the workers were girls whose ages ranged from 15 to 21. From a careful observation of these girls at work, and from a keenly interested study of their mode of life, we derived no impression that they were subjects of exploitation.

The members of our mission agreed that the mills in which these girls worked were faultlessly clean. We also agreed, without hesitation, that their living quarters were exceedingly pleasant and comfortable, and in addition, met every requirement of health and sanitation. Their food is of the best, prepared by expert dietitians and conforming obviously to the highest standards of a well-balanced and ample diet.

Adequate recreation and amusement facilities were also present. In addition, they have every day two hours of class-room instruction in language, literature, history and the arts under competent instructors provided by the mill management. Free medical attention and hospitalization are also provided. Even religious instruction is not overlooked, and it was our privilege to see about 800 girls engaged in their daily devotions. Their morals are guarded with extreme care, the girls being permitted to leave the mill compound only for proper reasons and in groups under responsible chaperonage.

To be sure, in terms of American money, the wages are low. The average wage for each girl is eight-tenths of one yen per day, equivalent to about 22 cents in our money. In addition to this pay, the girls receive free lodging, hospitalization and school instruction.

They are assessed the equivalent of about four cents a day for meals, which means that after all necessary living expenses have been met, each worker has a net saving which approximates one-half yen per day. At the end of a three-year working period, they usually return home with a neat dowry which may amount to as much as 400 yen, and which to the Japanese working class is roughly equivalent in purchasing power to the same number of American dollars. These girls go to the mills only after they have finished their high school courses, and their employment at the mills, under a contract entered into with their parents, is designed to utilize the period between the completion of high school and the attainment of the marriageable age.

It is my judgment that in our competition with the Japanese textile industry we are not competing with labor exploitation or with lower living standards. It is much more correct to say that we are competing with a totally different mode of life, the elements of which are not comparable with those prevailing in America.

In the relationship of our two industries, there is no just basis for recrimination, suspicion or deprecation. If such a basis does not exist in reality, there is no reason why it should be artificially produced by resort to the imagination.

A Summing Up

The "standard of living" or "living customs" of the peoples of Asia have been different from those of the West, because of the conditions described. Limited as they have been, the Japanese people have learned to live very simply. They have simple homes, with little heat, little of furnishings, sleep and eat on the floor, have simple food (rice, fish and vegetables, without meat or dairy products). As Dr. Murchison has said: they have a "different mode of life," adapting themselves happily to conditions they could not change. Thus the products of labor, and wages of labor, if valued in American dollars and in comparison with the products of American labor, seem very small. In truth, this comparison should not be made. Wages are lower in China, India and all other parts of Asia than in Japan, because the latter now has more of the western industrialism than those countries. The fact is that from Japan westward, across Asia and Europe, to Germany, England and the United States, wages are higher and higher in proportion to the increasing productivity of industry, as it is provided with the latest and best equipment. Wages are a share of the product, whether related to it by any agreement or not, and the "real" wage, i.e., each individual's share of the value produced, rises naturally as production per worker increases. The volume and variety of production clearly limit and determine the standard of living. A "rising standard of living" for a people means constantly having and consuming more "things" in the homes, and how can they have more "things" unless more are produced?

The cotton goods industry of Japan has followed the pattern of the silk industry, in being closely related to agriculture, which practically is gardening; and the wages of workers naturally are on a corresponding scale. Moreover, so many Japanese industries are thus related to agriculture that the agricultural wage is a tie between them all, and all wages and prices are necessarily related to the purchasing power of the mass. These conditions are important in considering the feasibility of any plan for inducing Japan, China and the remainder of Asia to join a world movement for raising wages and prices, and shortening working hours. No single industry of any country can segregate itself from the other industries with which it is exchanging products and services. Their business relations must be mainly at home, and their products must have stable values in relation to each other, or they cannot be sold. In any country, if a single group of the system succeeds in forcing its products above their accustomed exchange relations with others, that group is sure to lose more by unemployment than it can gain by any nominal rise of its prices. The exchanges between the West and the East should be so directed as to avoid violent disturbances, and make the trade advantageous to both sides. The compact between the United States and Japan looks to this solution of what might be a serious problem.

There is much in this movement of the cotton goods industry, from the countries that were first in its development to the lower-wage countries, which parallels the movement in the United States from New England to the lower-wage States of the South. The low wages of

the South were the primary cause of this movement, but they were low because of the lack of industries there, and the movement of the industries has tended to *level-up* Southern wages from what they were before. Furthermore, New England has not been deserted, nor did its wage-level fall. As in the case of Old England, she is making more of the fine textiles than ever before, and making many new products, such as machine-tools, aeroplanes, electrical equipment, new "Yankee notions," etc., thus continually demonstrating that there is no end of business for people who are alive.

The new cotton goods industry of Asia and South America is being built up mainly within itself, as the iron and steel, automobile, our own textile industry, and all the large industries of this country, have been built up, viz: by reducing costs and prices, and thus increasing consumption. The result has been not less employment, but more "things." All have drawn labor from agriculture, as the Japanese spinning and weaving industries have done, by offering better pay than could be had on the farms. The vast expansion of the urban population in this country has been accomplished in this way, and many more workers may be transferred from the farms in the same manner, to the advantage of themselves and the remaining farmers. There is no remedy for low wages but by improving, enlarging and balancing the industries, to increase the flow of trade; all of which requires increasing supplies of capital, and results in an increasing demand for labor and rising wages. This has been the history of industrial development everywhere.

The Cotton-Growers Place in the Industry

The most serious question relates to the effects of this "revolution" in the cotton goods industry upon the cotton-growers. There are about 2,000,000 farms in this country on which cotton is grown, and the number of persons in families dependent upon cotton-growing and cotton-handling of course is much larger. We mentioned last month that cotton production in this country in recent years has been a declining share of the world crop. Our exports in the present crop year (since August 1, 1936) have been "30 per cent below the long-time average and 9 per cent under last season," according to the official report.

Obviously this must be the tendency under a continuing distribution of the cotton goods industry over the world. Europe could not grow cotton and looked to the United States for its supply, but the new cotton goods countries will grow the cotton if they can. Cotton grows in a belt reaching around the world. Every province in China and India grows cotton, and although of inferior quality and yield, this is the fault of seed and culture, rather than of soil or climate.

Japan and India now have an agreement under which, for every 1,000,000 bales of Indian cotton purchased by the former, India will admit 283,000,000 yards of cotton piece-goods from Japan. The latter must trade wherever she can.

Another straw as to Asiatic development is the following item from a trade report of the Bureau of Foreign and Domestic Commerce (Washington) dated Shanghai, February 1, 1937:

> In 1936 the cotton mills of China enjoyed the greatest activity in recent years and yarn demands in the interior were at unusually high levels since the beginning of the new season. Thus, the year ended with a very propitious outlook in the cotton industry. Through Japanese encouragement, the expansion and improvement of raw cotton in North China is being stimulated, not only as a source of supply for Japanese cotton mills in China, but also for the industry in Japan.

Every country in South America produces cotton, excepting Chile, where the tropical section is too dry, and every one of these countries, not excepting Chile, now has cotton mills. Brazil, with a population of 47,000,000, now is self-sufficing both as to cotton cloth and raw cotton, is exporting cotton to Europe in annually increasing quantities, and cotton cloth to other South American countries and Cuba. On account of the reciprocity treaty between the United States and Cuba, under which each country gives to the other a 20 per cent preference reduction of import duties, Cuba has been almost the last stand of American cotton goods in the outside world. But American exporters are saying that the 20 per cent preference rate on cotton goods should be raised to 60 per cent in order to give the United States a competitive chance against either Japan or Brazil. Furthermore, Cuba has both unemployment and low wages, and is wanting to make cotton goods for herself. She has been buying cotton yarns from our Southern spinning mills, but Brazil is underselling them, not only because her spinning wages are lower, but because she grows her own cotton, and at lower costs for wages, taxes, etc.

All of this is interesting news on the eve of another International Textile Conference at Geneva, where an effort will be made to pledge all nations to the 40 hour week in the cotton goods industry. Approximately one-half of the United States cotton crop is exported, but if neither cotton, cotton yarn nor cotton cloth can be sold in Cuba, what can we do with a surplus of either? How will raising wages or shortening hours in the cotton mills of this country help sales either in foreign markets or at home, or help the American farmer? There will be no legislation limiting the farmer's work-week, but he will pay the higher costs of cotton clothing, along with every one else. Also, what will be done with the land and the farmers now producing nearly one-half of this country's cotton crop?

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